VERIZON COMMUNICATIONS
BIENNIAL ENGAGEMENT PROCESS

INTRODUCTION

Background

1. Section 272(a) of the Communications Act of 1934, as amended (the Act), requires that a Bell Operating Company (BOC) set up one or more separate affiliates before engaging in manufacturing activities, in-region interLATA services, and interLATA information services. For interLATA information services, this requirement expired on February 8, 2000 in accordance with the Act. Before engaging in the provision of in-region interLATA services, a BOC or an affiliate of the BOC must meet the requirements of section 271 of the Act and must receive approval by the Federal Communications Commission (FCC). A BOC that is required to operate a separate affiliate under section 272 must obtain and pay for a joint Federal/State audit every two years.[5]

2. The Commission adopted rules to implement the section 272(d) biennial audit requirement. *See Accounting Safeguards Order* at paras. 197-205; *see also* 47 C.F.R. § 53.209-.213. The Commission's part 53 rules and accompanying orders govern the conduct of the section 272(d) biennial audit. As stated in the Commission's part 53 rules, the purpose of the section 272(d) biennial audit is to determine whether the BOC and its section 272 affiliates have operated in accordance with the accounting and non-accounting safeguards required by section 272 of the Act and the Commissions rules. 47 C.F.R. § 53.209(b) (listing the specified compliance requirements of the section 272(d) biennial audit). In addition to specifying the audit requirements, the Commission's rules provide for the establishment of a Federal/State joint audit team that is authorized to oversee the conduct of the audit from the planning stage to its completion and to "direct the independent auditor to take any actions necessary to ensure compliance with the audit requirements [in 47 C.F.R. § 53.209(b)]." 47 C.F.R. § 53.209(d). Although the section 272(d) biennial audit is to be conducted by an independent auditor, the Federal/State joint audit team is also responsible for ensuring that the audit meets the objectives stated in the Commission's rules and orders. 47 C.F.R. §§ 53.209(d) (stating that the Federal/State joint audit team is responsible for "overseeing the planning of the audit"); 53.211(b) (requiring the Federal/State joint audit team to review the audit requirements and authorizing the Federal/State joint audit team to modify the audit program); 53.211(c) (authorizing the Federal/State joint audit team to approve the audit requirements and program); 53.211(d). In accordance with Statements on Standards For Attestation Engagements, 10, Paragraph 1.03: "When a practitioner undertakes an attest engagement for the benefit of a government body or agency and agrees to follow specified government standards, guides,

[5] 47 U.S.C. § 272(d).

procedures, statutes, rules and regulations, the practitioner is obliged to follow those governmental requirements as well as applicable attestation standards."

3. Working pursuant to delegated authority, the Federal/State joint audit team elected to use the Agreed-Upon Procedures (AUP) form of attestation engagement to meet the objectives specified in the Commission's rules, *i.e.*, to determine whether the BOC and its section 272 affiliates complied with the relevant accounting and non-accounting safeguards. The American Institute of Certified Public Accountants (AICPA) defines an AUP engagement as "one in which a practitioner is engaged by a client to issue a report of findings based on specific procedures performed on subject matter."[6] For the purposes of planning this AUP engagement and developing the appropriate audit procedures, the "specified parties" consist of the Federal/State joint audit team ("Oversight Team" or "Joint Oversight Team") and the company responsible for obtaining and paying for the section 272(d) biennial audits (*i.e.*, Verizon). The Oversight Team will be comprised of members from the FCC and members of the state commissions who have jurisdiction over Verizon in their respective states[7] and who have chosen to participate in the Biennial Audit and have either signed a Protective Agreement or the State commission has promulgated a Protective Order.

The Oversight Team is responsible for reviewing the conduct of the engagement and, after having apprised Verizon of their intention, for directing the practitioner to take such action as the team finds necessary to achieve each audit objective. Consistent with part 53.209(d) of the Commission's rules, the Oversight Team may direct the independent auditor to take any actions necessary to ensure compliance with the audit requirements of part 53.209(b) as reflected in letters or orders issued by the Bureau staff and served on Verizon. If Verizon disagrees with the Oversight Team's directions, the Oversight Team will issue a written decision describing the specific directions to which Verizon objects. Verizon may file a petition for reconsideration of that decision with the Enforcement Bureau pursuant to part 1.106 of the Commission's rules. The specified parties agree that the independent auditor shall implement the directions of the Oversight Team ten business days after such decision is issued if Verizon has not filed a petition for reconsideration. The specified parties further agree that if the Enforcement Bureau denies any part of Verizon's petition for reconsideration, the independent auditor shall immediately implement the Enforcement Bureau's decision.

Verizon may also file an Application for Review of the Enforcement Bureau's decision pursuant to part 1.115 of the Commission's rules. The independent auditor shall nonetheless implement the Enforcement Bureau's decision even if Verizon files an Application for Review of that decision. Should the Commission grant any part of Verizon's application for review, the independent auditor shall modify its procedures accordingly. In the event that Verizon's application for review has not been acted on by the date of the filing of the final biennial audit

[6] Statement on Standards for Attestation Engagements (SSAE) 10, paragraph 2.03, published by the American Institute of Certified Public Accountants.
[7] Connecticut, District of Columbia, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont, Virginia, and West Virginia.

report, the results of any such affected procedures shall be omitted from the final biennial audit report until such time as the Commission issues a final decision; however, the issues under review shall be disclosed in the final biennial audit report as matters subject to an application for review with the Commission that have not yet been acted upon.

The text below provides the requirements for the engagement as listed in part 53.209(b) of the FCC rules and indicates the nature, timing, and extent of the AUP for each requirement. It should be noted that AUP engagements are not based on the concept of materiality, therefore, the practitioner must report all results in the form of findings from application of the agreed upon procedures.

COMPLIANCE REQUIREMENTS

4. The requirements that will be covered in the Biennial Audit are contained in 47 U.S.C. Section 272(b), (c), and (e) of the Communications Act of 1934, as amended, and in 47 C.F.R. Part 53.209(b) of the FCC rules and regulations. Below is a listing of those requirements:

Structural Requirements

The separate affiliate required under section 272 of the Act:

I. Shall operate independently from the Bell operating company;

II. Shall maintain books, records, and accounts in the manner prescribed by the Commission that are separate from the books, records, and accounts maintained by the Bell operating company;

III. Shall have officers, directors, and employees that are separate from those of the Bell operating company;

IV. May not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Bell operating company;

Accounting Requirements

The separate affiliate required under section 272 of the Act:

V. Shall conduct all transactions with the Bell operating company on an arm's length basis with the transactions reduced to writing and available for public inspection.

The Bell operating company:

VI. Shall account for all transactions with the separate affiliate in accordance with the accounting principles and rules approved by the Commission.

Nondiscrimination Requirements

The Bell operating company:

VII. May not discriminate between the separate affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or the establishment of standards;

VIII. Shall fulfill any requests from unaffiliated entities for telephone exchange service and exchange access within a period no longer than the period in which it provides such telephone exchange service and exchange access to itself or its affiliates;

IX. Shall not provide any facilities, services, or information concerning its provision of exchange access to the section 272 affiliate unless such facilities, services, or information are made available to other providers of interLATA services in that market on the same terms and conditions;

X. Shall charge its separate affiliate under section 272, or impute to itself (if using the access for its provision of its own services), an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service;

XI. May provide any interLATA or intraLATA facilities or services to its interLATA affiliate if such services or facilities are made available to all carriers at the same rates and on the same terms and conditions, and so long as the costs are appropriately allocated.

Related FCC Dockets

5. These requirements have been clarified and expanded upon in several FCC proceedings. These proceedings are subject to further modification in subsequent FCC orders, or in orders on reconsideration. Below is a list of FCC orders related to the above requirements:

CC Docket No. 96-149, In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended; *First Report and Order and Further Notice of Proposed Rulemaking*; Released December 24, 1996. Other releases under this docket were issued on February 19, 1997; June 24, 1997; June 10, 1998; September 3, 1999; April 27, 2001.

CC Docket No. 96-150, In the Matter of Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996; *Report and Order*; Released December 24, 1996. Another release under this docket was issued on June 30, 1999.

CC Docket No. 96-98, In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; *First Report and Order*; Released August 8, 1996 (First Interconnection Order); *Second Report and Order and Memorandum Opinion and Order*; Released August 8, 1996 (Second Interconnection Order).

CC Docket No. 96-115, In the Matter of Implementation of the Telecommunications Act of 1996: Telecommunications Carriers' Use of Customer Proprietary Network Information and Other Customer Information; *Second Report and Order and Further Notice of Proposed Rulemaking*; Released February 26, 1998.

CC Docket No. 00-199, In the Matter of 2000 Biennial Regulatory Review -- Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2; *Report and Order and Further Notice of Proposed Rulemaking*; Released November 5, 2001.

CC Docket No. 98-121, In the Matter of Application of BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana; *Memorandum Opinion and Order*; Released October 13, 1998.

WC Docket No. 02-112, In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements; *Memorandum Opinion and Order*; Released December 23, 2002.

WC Docket No. 03-228, In the Matter of Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates; *Report and Order*; Released March 17, 2004.

6. In addition, the following pending FCC dockets may, if applicable to the activities of the BOC, result in additional regulations surrounding the Nondiscriminatory Requirements:

Notice of Proposed Rulemaking, FCC 01-339, released on November 19, 2001, dealing with several dockets, among which, CC Docket No. 01-321 Performance Measurements and Standards for Interstate Special Access Services; CC Docket No. 96-149 Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended; RM 10329 AT&T Corp. Petition to Establish Performance Standards, Reporting Requirements, and Self-Executing Remedies Need to Ensure Compliance by ILECs with Their Statutory Obligations Regarding Special Access Services.

Notice of Proposed Rulemaking, FCC 01-331, released on November 19, 2001, dealing with several dockets, among which, CC Docket No. 01-318 Performance Measurements and Standards for Unbundled Network Elements and Interconnection; CC Docket No. 98-56 Performance Measurements and Reporting Requirements for Operations Support Systems, Interconnection, and Operator Services and Directory Assistance.

The proposed regulations are to be considered by the practitioner only if adopted by the FCC, applicable to section 272 relationships and to the extent in effect during the engagement period.

ENGAGEMENT PLAN

Engagement Period

7. The AUP engagement shall cover 24 months of operations beginning January 3, 2003 and ending January 2, 2005 for all states where Verizon has obtained authority to provide in-region interLATA services. For all of the Verizon section 272 affiliates the engagement will also cover all assets added since the last audit. The biennial audit will cover all services for which a separate affiliate is required under section 272(a)(2) and includes all BOCs within the Region and ILECs providing or receiving services to/from the section 272 affiliates. The Audit Test Period will be from January 3, 2003 through September 30, 2004, except where noted.

Sunset Provisions

8. Section 272(f)(1) of the Communications Act provides that section 272 (other than subsection (e)) shall cease to apply to the interLATA telecommunications services of a BOC three years after the date the BOC receives authorization to provide interLATA telecommunications services under section 271(d), unless the Commission extends such three-year period by rule or order. Thus, section 272(d) which concerns the Biennial Audit sunsets three years after section 271 authorization. The Commission has determined that such "sunset" shall apply on a state-by-state basis according to the date that each state receives section 271 authorization.[8] Therefore, as each state within the Verizon region sunsets, that state may be excluded from further section 272 audits as of the date of sunset as recognized by the FCC. However, if a BOC in a given state has affiliate transactions with any section 272 affiliate, those transactions will continue to be part of the audit because of the continuation of the Commission's rules governing affiliate transactions in part 32.

[8] WC Docket No. 02-112, In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements; *Memorandum Opinion and Order*; Released December 23, 2002.

Accordingly, operations in the following states may be excluded from this engagement as of the effective date of the related FCC public notice:

State	Sunset Effective Date
New York	December 23, 2002[9]
Massachusetts	April 16, 2004[10]
Connecticut	July 20, 2004[11]
Pennsylvania	September 19, 2004[12]
Rhode Island	February 24, 2005[13]
Vermont	April 17, 2005[14]

The Commission has ruled that a BOC will be deemed nondominant in the provision of in-region, interLATA, domestic, interstate service only insofar as that service is provided through an affiliate that complies with section 272 and the FCC's implementing rules.[15] Therefore, operations in each of the sunset states will be included in this engagement unless Verizon gives notice that it has elected to stop providing in-region, interLATA, domestic, interstate service through an affiliate that complies with section 272 and the FCC's implementing rules in a particular state(s). Without such notice provided to the Federal/State joint audit team prior to the date the independent auditor begins its audit work, all states will be included in the engagement regardless of sunset status.

Sampling

9. Certain audit procedures may require testing on a sample basis. The sample sizes and sampling methodologies to be used in performing such audit procedures shall be determined after the initial survey and/or during the performance of the audit of the section 272 affiliate. Such determinations shall be made jointly by the practitioner and specified parties. During this

---

[9] WC Docket No. 02-112, Section 272 Sunsets for Verizon in New York State by Operation of Law on December 23, 2002 Pursuant to Section 272(f)(1); *Public Notice*; Released December 23, 2002.

[10] WC Docket No. 02-112, Section 272 Sunsets for Verizon Communications, Inc. in the State of Massachusetts by Operation of Law on April 16, 2004 Pursuant to Section 272(f)(1); *Public Notice*; Released April 16, 2004.

[11] WC Docket No. 02-112, Section 272 Sunsets for Verizon Communications, Inc. in the State of Connecticut by Operation of Law on July 20, 2004 Pursuant to Section 272(f)(1); *Public Notice*; Released July 20, 2004.

[12] WC Docket No. 02-112, Section 272 Sunset for Verizon Communications, Inc. in the State of Pennsylvania by Operation of Law on September 19, 2004 Pursuant to Section 272(f)(1); *Public Notice*; Released September 17, 2004.

[13] WC Docket No. 02-112, Section 272 Sunsets for Verizon Communications, Inc. in the State of Rhode Island by Operation of Law on February 24, 2005 Pursuant to Section 272(f)(1); *Public Notice*; Released February 24, 2005.

[14] WC Docket No. 02-112, Section 272 Sunsets for Verizon Communications, Inc. in the State of Vermont by Operation of Law on April 17, 2005 Pursuant to Section 272(f)(1); *Public Notice*; Released April 20, 2005.

[15] CC Docket No. 96-149, In the Matter of Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area; *Second Report and Order*; Released April 18, 1997. WC Docket No. 02-112, In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements; *Memorandum Opinion and Order*; Released December 23, 2002.

process, the practitioner shall obtain detailed listings or lists (representing the population of potential items to be tested) for each procedure. For those procedures requiring statistical sampling, the practitioner shall develop detailed statistical parameters that include the total number of items in the universe, the number of items sampled, method of selection. Where the specified parties and practitioner indicate, and when appropriate, the practitioner shall select a statistically valid sample using random and stratified sampling techniques with the following parameters: a desired confidence level equal to 95%; a desired upper precision limit equal to 5%; and an expected error rate of 1%. Taking under consideration cost versus benefit to be derived, the Oversight Team shall approve the sampling plan, after consulting with Verizon, when reviewing the detailed procedures written by the practitioner and/or during the execution of the procedures.

10. Generally, the practitioner should consider all data and information falling within the engagement period; however, unless otherwise stated in this document or accepted by the Oversight Team, the practitioner should obtain data and information as of the latest period available during the engagement period. For procedures requiring sampling sizes to be based on information available as of the end of the Audit Test Period, the practitioner will utilize September 30 as the relevant date, unless otherwise noted. In addition, to the extent that the companies' processes and procedures change between the time of execution of these procedures and the end of the engagement period, the practitioner has an obligation to test these changes to ensure continued compliance with the section 272 requirements.

Definitions

11. <u>*BOC*</u> If the BOC transfers or assigns to an affiliated entity ownership of any network elements that must be provided on an unbundled basis pursuant to section 251(c)(3), such entity shall be subject to all of the requirements of the BOC. For purposes of this engagement, in the event that the BOC provides exchange and/or exchange access services on a retail or wholesale basis exclusively through one or more of its subsidiaries or affiliates, or through one or more other subsidiaries, divisions, etc., of the parent Regional Holding Company, and the same services cannot be purchased directly from the BOC, then these entities shall also be subject to all of the relevant nondiscriminatory requirements of Objectives VII through XI of this document. Affiliates that merely resell the BOC's exchange services and/or exchange access services or lease unbundled elements from the BOC, or engage in permissible joint marketing activities (see section 272(g)(1) of the Act), shall be excluded from these requirements.

12. <u>*Verizon BOC*</u> For the purposes of this engagement, the term "Verizon BOC" includes the following former Bell Atlantic telephone operating companies: Verizon New York, Inc., Verizon New England, Inc., Verizon – Washington, D.C., Inc., Verizon – Maryland, Inc., Verizon – Virginia, Inc., Verizon – West Virginia, Inc., Verizon – New Jersey, Inc., Verizon – Pennsylvania, Inc., Verizon – Delaware, Inc., and any successor or assign of such company as described in ¶11. The term "BOC", for purposes of this engagement, does not include the former GTE telephone operating companies listed below; they shall be termed "ILECs".

The term "ILEC" (Incumbent Local Exchange Carrier) includes the following former GTE telephone companies: Verizon California, Inc., Verizon Florida, Inc., Verizon Hawaii, Inc., Verizon Mid-States (Contel of the South, Inc.), Verizon North, Inc., Verizon Northwest, Inc., Verizon South, Inc., Verizon Southwest (GTE Southwest, Inc.), Verizon West Coast, Inc., Puerto Rico Telephone Company (PRTC), the Micronesian Telecommunications Corp. (MTC), and any successor or assign of such company as described in ¶11 until the date of sale of such company to a company not affiliated with Verizon.

In addition, for the purpose of this engagement, Verizon Advanced Data Inc. (VADI) and VADI Virginia are to be treated as ILECs after the September 26, 2001 order, *Bell Atlantic/GTE Merger,* 16 FCC Rcd 16915 (2001). As of December 31, 2003, VADI's operations were reintegrated with the ILEC operations. VADI is considered a nonregulated affiliate since several employees remain on the VADI payroll and provide services to the ILEC's.

13. *Affiliate* The term "affiliate" shall refer to a person that (directly or indirectly) owns or controls, is owned or controlled by, or is under common ownership or control with, another person. For this purpose, the term "own" means to own an equity interest (or the equivalent thereof) of more than 10 percent. (*See* section 3 of the Communications Act of 1934, as amended.)

14. *Verizon Section 272 Affiliate* The audit procedures are required to be performed, unless otherwise specified, on all section 272 affiliates as defined by the Act. For the purposes of this engagement, the term "separate affiliate" or "section 272 affiliate" includes the following companies: Bell Atlantic Communications, Inc. (d/b/a/ Verizon Long Distance); NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions); Verizon Global Networks, Inc.; and Verizon Global Solutions, Inc.. It also includes the following section 272 affiliates resulting from the Bell Atlantic/GTE merger: Verizon Select Services Inc. (VSSI) (formerly GTE Communications Corp.); Codetel International Communications Inc. (CICI); TELUS Communications Inc. (TCI); TELUS Communications (Quebec) Inc. (TCQI); any other affiliate that originates InterLATA telecommunications services in the Verizon region that is subject to section 272 separation requirements; and any affiliate that engages in manufacturing activities as defined in section 273(h).

15. *Official Services* Official Services mean those services permitted by the United States District Court for the District of Columbia in United States v. Western Electric Co. Inc. See 569 F. Supp. 1057, 1098, n.179 (1983) (defined as "communications between personnel or equipment of an Operating Company located in various areas and communications between Operating Companies and their customers"), and its progeny.

16. *Obtain* For purposes of this engagement, the term "obtain" as referred to in the procedures contained herein, shall mean that the practitioner will physically acquire, and generally retain in the working papers, all documents supporting the work effort performed to

adequately satisfy the requirements of a procedure. The practitioner, in their professional judgement, shall decide which items are too voluminous to include in the working papers. The practitioner shall include a narrative description of the size of such items as well as any other reasons for their decision not to include them in the working papers.

Conditions of Engagement

17. The practitioner leading this engagement shall be a licensed CPA. The practitioner's team performing the engagement shall be familiar with the standards established for an agreed-upon procedures engagement, the requirements for the Biennial Audit, and its objectives. The team performing the engagement shall also be independent as defined in the Statements on Standards for Attestation Engagements (SSAE 10, paragraphs 1.35-1.38) and in compliance with the Sarbanes-Oxley Act of 2002. The practitioner shall disclose in its engagement letter to Verizon how the team shall comply with the independence requirements of the Sarbanes-Oxley Act of 2002. All members of the team performing the engagement shall have a sufficient general understanding of the relevant information contained in the following documents:

- Sections 271 and 272 of the Communications Act of 1934, as Amended;

- Part 32.27, Transactions with Affiliates, of the FCC's Uniform System of Accounts for Telecommunications Companies (USOA);

- The relevant orders and rules from the following FCC Dockets:

  a. CC Docket No. 86-111 dealing with the allocation of joint costs between the regulated and nonregulated activities of the telephone company;

  b. CC Docket No. 96-149 dealing with the implementation of the non-accounting safeguards of sections 271 and 272 of the Act;

  c. CC Docket No. 96-150 dealing with the implementation of the accounting safeguards of sections 271 and 272 of the Act;

  d. CC Docket No. 96-98 dealing with the implementation of the local competition provisions of the Act (the interconnection orders);

  e. CC Docket No. 96-115 dealing with the use of customer proprietary network information;

  f. Notice of Proposed Rulemaking, FCC 01-339, released on November 19, 2001, dealing with several dockets, among which, CC Docket No. 01-321 Performance Measurements and Standards for

Interstate Special Access Services; CC Docket No. 96-149 Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended; RM 10329 AT&T Corp. Petition to Establish Performance Standards, Reporting Requirements, and Self-Executing Remedies Need to Ensure Compliance by ILECs with Their Statutory Obligations Regarding Special Access Services. The proposed regulations are to be considered by the practitioner only if adopted by the FCC, applicable to section 272 relationships and to the extent in effect during the engagement period.

g. Notice of Proposed Rulemaking, FCC 01-331, released on November 19, 2001, dealing with several dockets, among which, CC Docket No. 01-318 Performance Measurements and Standards for Unbundled Network Elements and Interconnection; CC Docket No. 98-56 Performance Measurements and Reporting Requirements for Operations Support Systems, Interconnection, and Operator Services and Directory Assistance. The proposed regulations are to be considered by the practitioner only if adopted by the FCC, applicable to section 272 relationships and to the extent in effect during the engagement period.

- Verizon's section 271 application(s) and related FCC approval(s);

- Orders issued by state commissions approving interconnection agreements that are covered in the scope of the engagement;

- Petitions for arbitration with the BOC for those agreements tested within the

engagement.

18. In addition, to the extent the practitioner determines procedures included in this plan cannot be performed, the practitioner will propose alternate procedures to the Oversight Team, as appropriate. The practitioner will inform the Oversight Team if the practitioner determines it is necessary to modify the agreed upon procedures or the scope of the engagement, in order to provide the specified parties with all of the information needed to determine compliance with the various requirements. The practitioner shall include any additional hours and fees that would result from revisions of the procedures or of the scope of the engagement. After the practitioner informs the Oversight Team of any revisions to the final audit program or to the scope of the audit, the Oversight Team shall inform Verizon about these revisions. These revisions will be subject to the procedures described in paragraph 3 above.

19. The practitioner may use the services of a specialist for assistance in highly technical areas. The practitioner and the specified parties shall explicitly agree to the

involvement of any specialist to assist in the performance of the engagement. The specialist shall not be affiliated in any form with Verizon.

20. The practitioner's use of internal auditors shall be limited to the provision of general assistance and the preparation of schedules and gathering of data for use in the engagement. Under no circumstances shall the internal auditors perform any of the procedures contained in this document. All the procedures in this document shall be performed by the practitioner.

21. The practitioner shall not use or rely on any of the procedures performed during any of the Verizon BOC/ILEC cost allocation manual (CAM) audits to satisfy any of the requirements in Objectives V/VI.

Representation Letters

22. The practitioner shall obtain three types of representation (assertion) letters. The first type of representation letter shall address all items of an operational nature (see para. 23). The second type of representation letter shall address all items of a financial nature (see para. 24). The third type of representation letter shall state that all section 272 affiliates have been disclosed (see para. 25). The following paragraphs detail the contents of each type of representation letter.

23. The representation letters related to operations issues shall be signed by the Chief Operating Officer or the equivalent of each Verizon BOC/ILEC and each section 272 affiliate and shall include the following:

a. acknowledgement of management responsibility for complying with specified requirements;

b. acknowledgement of management responsibility for establishing and maintaining an effective internal control structure over compliance;

c. statement that Verizon has performed an internal evaluation of its compliance with the specified requirements;

d. statement that management has disclosed or will disclose to the practitioner all known noncompliance occurring up to the date of the draft report;

e. statement that management has made available all documentation related to compliance with the specified requirements;

f. statement that management has disclosed all written communications from regulatory agencies, internal auditors, external auditors, and other practitioners, and any written formal or informal complaints to regulatory agencies from competitors, concerning possible noncompliance with the specified requirements, including communications received between the end of the period addressed in management's assertion and the date of the practitioner's report;

g. statements that: each section 272 affiliate operates independently from all Verizon BOCs/ILECs; no Verizon BOC/ILEC owns any facilities jointly with any section 272 affiliate; prior to March 30, 2004, no Verizon BOC/ILEC, or other affiliates other than any section 272 affiliate itself, provided any operating, installation, and maintenance functions over the facilities owned by the section 272 affiliates, or leased by the section 272 affiliates from unaffiliated entities; prior to March 30, 2004, no section 272 affiliate provided any operating, installation, and maintenance functions over any BOC/ILEC's facilities; and no Verizon BOC/ILEC is providing and did not provide any research and development that is a part of manufacturing on behalf of any section 272 affiliate pursuant to section 272(a);

h. statement that each section 272 affiliate has separate officers, directors, and employees from those of any Verizon BOC/ILEC;

i. statement that no Verizon BOC discriminated between itself or the section 272 affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or the establishment of standards (on each Verizon BOC's representation letter only);

j. statement that each Verizon BOC/ILEC subject to section 251(c) of the Act has fulfilled requests from unaffiliated entities for telephone exchange service and exchange access within a period no longer than the period in which it provides such telephone exchange service and exchange access to itself or its affiliates (on each Verizon BOC/ILEC's representation letter only);

k. statement that each Verizon BOC/ILEC subject to section 251(c) of the Act has made available facilities, services, or information concerning its provision of exchange access to other providers of interLATA services on the same terms and conditions as it has made available to its section 272 affiliates that operate in the same market (on each Verizon BOC/ILEC's representation letter only).

24. The representation letters related to financial issues shall be signed by the Chief Financial Officer or the equivalent of each Verizon BOC/ILEC and each section 272 affiliate and shall include the following:

a. statement that each section 272 affiliate maintains separate books, records, and accounts from those of any Verizon BOC/ILEC and that such separate books, records, and accounts are maintained in accordance with GAAP;

b. statement that each section 272 affiliate has not obtained credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of any Verizon BOC/ILEC;

c. statement that management has identified to the practitioner all assets transferred or sold since the last audit, and services rendered: (i) by each Verizon BOC/ILEC to each section 272 affiliate; and (ii) by each section 272 affiliate to each Verizon BOC/ILEC; and that these transactions have been accounted for in the required manner;

d. statement that each Verizon BOC/ILEC subject to section 251(c) of the Act has charged its section 272 affiliates, or imputed to itself (if using the access for its provision of its own services), an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service (on each Verizon BOC/ILEC's representation letter only);

e. statement that, if any Verizon BOC/ILEC and an affiliate subject to section 251(c) of the Act make available and/or have provided any interLATA facilities or services to an interLATA affiliate, such facilities or services are made available to all carriers at the same rates and on the same terms and conditions, and the associated costs are appropriately allocated (on each Verizon BOC/ILEC's representation letter only);

f. statement that management has not changed any of the Verizon BOC/ILEC processes or procedures (as they relate to transactions of any kind with a section 272 affiliate) and that these procedures and processes have continued to be implemented on a consistent basis, since the execution of these agreed-upon procedures without apprising the practitioner, before the date of the draft report (on each Verizon BOC/ILEC's representation letter only).

25. The representation letter related to the disclosure of all section 272 affiliates shall be signed by the Chief Financial Officer of Verizon and shall state that each section 272 affiliate has been identified, accounted for in the required manner, and disclosed in the required manner.

Engagement Process

26. The General Standard Procedures, which were drafted through the cooperative efforts of Federal and State Regulators and various industry groups, are intended to provide general areas of audit work coverage and uniformity of audit work among all regions, to the extent possible, considering state regulatory and corporate differences. The standards identified throughout this document are not legal interpretations of any rules or regulations. To the extent that these standards conflict with any FCC rules and regulations, the FCC rules and regulations govern. Accordingly, by agreeing to these procedures, neither the FCC nor Verizon concede any legal issue or waive any right to raise any legal issue concerning the matters addressed in these procedures.

27. The General Standard Procedures shall be used by Verizon as a guide for drafting the preliminary audit requirements, including the proposed scope of the audit, as prescribed in part 53.211(a) and (b) of the Commission's rules. Under these rules, Verizon shall submit the preliminary audit requirements, including the proposed scope and extent of testing, to the Oversight Team before engaging an independent accounting firm to conduct the Biennial Audit. The Oversight Team shall then have 30 days to review the preliminary audit requirements to determine whether they are adequate to meet the audit requirements in part 53.209 of the Commission's rules and "determine any modifications that shall be incorporated into the final audit requirements" (part 53.211(b)). The preliminary audit requirements and scope of the audit shall be similar to the General Standard Procedures and shall cover all the areas described in that model. Verizon shall not engage any practitioner who has been instrumental during the past two years in designing any of the systems under review in the Biennial Audit. After Verizon has engaged a practitioner to perform the Biennial Audit, the process for drafting detailed procedures shall proceed as follows:

- The Oversight Team and the practitioner shall perform a joint survey of the section 272 affiliates and the relevant Verizon BOC/ILECs. The Oversight Team and the practitioner shall coordinate with Verizon to determine the nature, timing and extent of this survey at a mutually agreeable time and location. The survey shall provide the practitioner and the Oversight Team with an overview of the company's structure and policies and procedures such as record keeping processes, the extent of affiliate transactions, and Verizon BOC/ILEC procedures for processing orders for services received from affiliates, unaffiliated entities, and its own end-user customers. The survey shall be conducted between four to six months before the end of the period to be covered by this engagement.

- The practitioner shall develop a detailed audit program based on the final audit requirements and submit it for review to the Oversight Team (part 53.211(d)).

- The Oversight Team shall have 30 days to review the detailed procedures for consistency and adequacy of audit coverage and shall provide to the practitioner any modifications that shall be incorporated into the final audit program (part 53.211(d)).

28. Access to all information during the section 272(d) biennial audit shall be restricted to: (a) FCC staff members; (b) state commission staff members where the state commission by statute protects company proprietary data; (c) state commission staff members who have signed a protective agreement with Verizon; (d) state commission staff members of any participating state that has confidentiality procedures in effect covering all staff and that requires the Chairman or designee to sign the protective agreement on behalf of the entire commission including commission staff; and (e) state commission staff members who have not

signed the protective agreement, but that Verizon does not object to provide oral or written information, provided that they do not take possession of such information.

29. The detailed examination of transactions shall begin at such time as the practitioner deems appropriate to complete the engagement in accordance with the time schedule set forth in part 53.211 and part 53.213 of the Commission's rules.

30. During the conduct of this engagement, and until issuance of the final report to the Commissions, the practitioner shall schedule monthly meetings with the Oversight Team and, at the discretion of the practitioner and the Oversight Team, with Verizon, to discuss the progress of the engagement. The practitioner shall inform the Oversight Team well in advance, but not less than ten days, of plans to meet with representatives of Verizon for the following reasons: to discuss plans and procedures for the engagement; to survey Verizon operations; to review Verizon procedures for maintaining books, records, and accounts; and to discuss problems encountered during the engagement. It shall not be necessary for the practitioner to inform the Oversight Team of meetings with the client to ask for clarification or explanation of certain items, explore what other records exist, or request data. The practitioner shall immediately inform in writing the Oversight Team of any deviation from, or revisions to, the final detailed audit procedures and provide explanations for such actions. The practitioner shall submit to the Chief, Enforcement Bureau, and shall copy the Oversight Team and, at the practitioner's discretion, Verizon, any rule interpretation necessary to complete the engagement. The practitioner shall advise the Oversight Team of the need for additional time to complete the engagement in the event that the Oversight Team requests additional procedures (see 31c. below). Finally, the practitioner shall immediately inform the Oversight Team in writing of any delay or failure by Verizon to respond to requests for information during the engagement.

Timetables

31. In order to complete the engagement in a timely manner, the following time schedule for completion of certain tasks is provided:

a. On March 3, 2005 and prior to discussing the findings with Verizon, the practitioner shall submit a draft of the report to the Oversight Team for all procedures.

b. The Oversight Team shall have until April 18, 2005 to review the findings and working papers and offer its recommendations, comments, and exceptions concerning the conduct of the engagement to the practitioner. The exceptions of the Oversight Team to the findings of the practitioner that remain unresolved shall be included in the final report.

c. If the Oversight Team requests additional procedures, the practitioner shall advise the Oversight Team and Verizon of any need for additional time to perform such procedures. Otherwise, after receiving the Oversight Team's recommendations and making the appropriate revisions, the practitioner shall submit the report by May 3, 2005 to Verizon for its comments on the findings, and to the Oversight Team.

d. By June 2, 2005, Verizon will comment on the findings and send a copy of its comments to both the practitioner and the Oversight Team. Verizon will also provide the practitioner and the Oversight Team notification of all items contained in the draft report, which Verizon contends to be confidential. The Verizon response shall be included as part of the final report.

e. By June 13, 2005, the practitioner may respond to Verizon's comments and shall make available for public inspection the final report by filing it with the regulatory agencies having jurisdiction over Verizon. The final report shall contain the procedures employed with the related findings, the Oversight Team's comments, Verizon's comments, the practitioner's reply comments, and a copy of these procedures as executed.

f. Interested parties shall have 60 days from the date the report is made available for public inspection to file comments with the Commission and/or any state regulatory agency.

Report Structure

32. Consistent with the AICPA standards for AUP engagements, the practitioner must present the results of performing the audit procedures in the form of findings, including dollar amounts, resulting from application of the audit procedures. The practitioner shall include in the report all the information required to be included in the report by the procedures and any further information required by the Oversight Team subject to the provisions of paragraph 3. The practitioner must avoid vague or ambiguous language in reporting the findings and shall describe in the final report all instances of noncompliance with section 272 or its related implementing rules that were noted by the practitioner in the course of the engagement, or disclosed by Verizon during the engagement and not covered by the performance of these procedures. Where samples are used to test data, the report shall identify the size of the universe from which the samples were drawn, the size of the sample, the sampling methodology used and, where appropriate, the standard deviation and mean. The final report shall contain the procedures employed with the related findings, the Oversight Team's comments, Verizon's comments, the practitioner's reply comments, and a copy of these procedures as executed. The practitioner's report must also contain the following elements:

a. A title that includes the word independent.

b. Identification of the specified parties.

c. Identification of the subject matter (or the written assertion related thereto) and the character of the engagement.

d. Identification of Verizon as the responsible party.

e. A statement that the subject matter is the responsibility of the responsible party.

f. A statement that the procedures performed were those agreed to by the specified parties identified in the report or as directed by the Bureau or the Commission, as specified in paragraph 3.

g. A statement that the agreed-upon procedures engagement was conducted in accordance with attestation standards established by the AICPA.

h. A statement that the sufficiency of the procedures is solely the responsibility of the specified parties and a disclaimer of responsibility for the sufficiency of those procedures.

i. A list of the procedures performed (or reference thereto) and related findings.

j. A statement that the practitioner was not engaged to and did not conduct an examination of the subject matter, the objective of which would be the expression of an opinion, a disclaimer of opinion on the subject matter, and a statement that if the practitioner had performed additional procedures, other matters might have come to his or her attention that would have been reported.

k. This report becomes a matter of public record via the practitioner's filing the final report with the FCC and the state regulatory agencies having jurisdiction over Verizon.

l. A description of any limitations imposed on the practitioner by the BOC/ILECs or any other affiliate, or other circumstances that might affect the practitioner's findings.

m. A description of the nature of the assistance provided by specialists and internal auditors.

VERIZON COMMUNICATIONS
BIENNIAL ENGAGEMENT PROCEDURES

Exceptions to the General Standard Procedures

I. Throughout these general standard procedures, reference is made to the 'section 272 affiliate'. Since Verizon has more than one 'section 272 affiliate,' the agreed upon procedures must be performed on all section 272 affiliates, unless stated otherwise in the specific procedures or covered by the exceptions below.

The following procedures will not be performed for CICI, TCI, and TCQI:
Objective I, Procedure 6;
Objective II, Procedures 1, 2, and 3;
Objective III, Procedure 2;
Objective IV, Procedures 1, 2, and 3; and
Objective V/VI, Procedure 9.

II. Throughout these general standard procedures, reference is made to the "BOC/ILEC." Since Verizon has more than one "BOC/ILEC," the agreed upon procedures must be performed on all BOC/ILECs, unless stated otherwise in the specific procedures or covered by the exceptions below.

A. For Objectives VIII through XI, where the procedures refer to "ILEC," the practitioner will perform the procedures only in states that the BOC received 271 authority as of the engagement period.

B. Objective III, Procedure 2, will not be performed for PRTC and MTC.

Follow-up Procedures on the Prior Engagement

I. The following matters were noted in the Verizon Communications Inc. Section 272 Biennial Agreed Upon Procedures Report dated June 12, 2003:

A. GTE Communication Systems Corporation, a non-regulated Verizon affiliate, acting through its Verizon Logistics division provided repair of plug-in cards for TCI (a former GTE section 272 affiliate) switches located in Canada from the merger closing date through 2002. As part of the repair service, Verizon Logistics tested the plug-in cards on a test switch owned by Verizon California. (Appendix B:2 in the 6/12/03 report, I-3 in this program)

B. Between January 18, 2001 and January 22, 2002, TCI's Systems Support and Repair organization located in Burnaby, British Columbia, repaired six Verizon GTD5 plug-in cards sent by Verizon Logistics for repair on behalf of Verizon Florida. (Appendix B:3 in the 6/12/03 report, I-3 in this program)

C. Two of 20 leases maintained by the section 272 affiliates were not properly recorded as capital leases according to GAAP. (Appendix A, II-2 in the 6/12/03 report, II-3 in this program)

D. Verizon disclosed that there were 9 instances of services provided between BOC/ILECs and section 272 affiliates without written affiliate agreements, and 6 instances of services provided between BOC/ILECs and former GTE section 272 affiliates without written affiliate agreements. (Appendix A, V/VI-4 and Appendix B-1, V/VI-4 in the 6/12/03 report, V/VI-4a in this program)

E. Fourteen of 81 agreements, and 7 of 121 amendments, between the BOC/ILECs and section 272 affiliates had discrepancies between the agreement and the information disclosed on the internet postings. (Appendix A, V/VI-5 in the 6/12/03 report, V/VI-5 in this program)

F. Some agreements and some parts of the agreements were not readily available for public inspection at the principal place of business. (Appendix A, V/VI-5 in the 6/12/03 report, V/VI-5 in this program)

G. Twenty-six new BOC/ILEC agreements/amendments with section 272 affiliates, and 2 new BOC/ILEC agreements with former GTE section 272 affiliates, executed during the audit period were not posted to the internet within the requisite ten days. (Appendix A, V/VI-5 and Appendix B-1, V/VI-5 in the 6/12/03 report, V/VI-5 in this program)

H. There were instances where the disclosures on the internet were incomplete. (Appendix A, V/VI-5 in the 6/12/03 report, V/VI-5 in this program)

I. For ten of 87 bills from section 272 affiliates to BOCs, management was unable to locate a corresponding amount in the BOCs' books. (Appendix A, V/VI-7 in the 6/12/03 report, V/VI-8 in this program)

J. Verizon BOCs purchased pre-paid calling cards from VSSI, a section 272 affiliate, without obtaining competitive bids. (Appendix A, VII-1 in the 6/12/03 report, VII-2 in this program)

K. Verizon BOCs' customer service representatives, in some instances, failed to give inbound customers the required equal access notifications. (Appendix A, VII-6 in the 6/12/03 report, VII-7 in this program)

L. For certain measurements for which the auditors attempted to replicate the calculation, discrepancies in the prescribed calculation method were found. (Appendix A, VIII-5 in the 6/12/03 report, VIII-5 in this program)

M. Verizon BOCs had several errors in their imputation calculations, and for several months no imputation amounts were booked. (Appendix A, X-2 in the 6/12/03 report, X-2 in this program)

II. When performing the procedures related to the above matters, the practitioner will note in the report whether these matters continued to exist beyond the previous engagement period, what action management took to ensure their non-recurrence or improvement, and the effective date of such action.

Procedures for Structural Requirements

OBJECTIVE I. Determine whether the separate affiliate required under section 272 of the Act has operated independently of the Bell operating company.

STANDARDS

The FCC has issued rules and regulations in CC No. Docket 96-149, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended. Some of those rules require that,

- A BOC and its section 272 affiliate cannot jointly own transmission and switching facilities, broadly defined as local exchange and exchange access facilities, or the land and buildings where those facilities are located. (See 47 C.F.R. part 53.203(a) and First Report and Order, para. 15, 158, 160)

- Prior to March 30, 2004, a section 272 affiliate shall not perform operating, installation or maintenance functions associated with the BOC's facilities. Likewise, prior to March 30, 2004, a BOC or any BOC affiliate, other than the section 272 affiliate itself, shall not perform operating, installation or maintenance functions associated with the facilities that each section 272 affiliate owns or leases from a provider other than the BOC with which it is affiliated. (See 47 C.F.R. part 53.203(a)(2), (3) and First Report and Order, para. 15, 158, 163; see also WC Docket No. 03-228, Report and Order, para. 8, 12, 16, 24, 31)

- To the extent that research and development is a part of manufacturing, it must be conducted through a section 272 affiliate. If a BOC seeks to develop services for or with its section 272 affiliate, the BOC must develop services on a nondiscriminatory basis for or with other entities pursuant to section 272(c)(1). (See First Report and Order, para. 169)

PROCEDURES

1. Inquire of management whether there have been any changes in the certificate of incorporation, bylaws, and articles of incorporation of the section 272 affiliates covered in this Biennial Audit, and whether there have been any legal and/or "doing business as" (DBA) name changes since the last engagement period. For each such change reported by management, and for any section 272 affiliate established or formed since the last engagement period, inspect the certificate of incorporation, bylaws, and articles of incorporation to determine whether these affiliates were established as corporations separate from the Verizon BOC/ILECs. Note in the report the results of this procedure.

2. Obtain and inspect corporate entities' organizational chart(s) and confirm, as appropriate, with legal representatives of the Verizon BOC/ILECs, section 272 affiliates, and Verizon Communications, the legal, reporting, and operational corporate structure of the section 272 affiliates. Disclose these facts in the report. Document and disclose in the report who owns the section 272 affiliates.

3. For the period prior to March 30, 2004, inquire of management, identify and document which entity performed operating, installation and maintenance functions over facilities either owned by each section 272 affiliate, or leased from a third party by each section 272 affiliate.

   a.) Obtain management's definition and interpretation of operating, installation, and maintenance (OI&M) functions. Describe in the report management's definition of OI&M.

   b.) For the period prior to March 30, 2004, disclose in the report whether or not any of these above described OI&M services were being performed by the Verizon BOC/ILECs and/or other non-section 272 affiliate(s) on facilities either owned by the section 272 affiliate or leased from a third party by the section 272 affiliate. For each such OI&M service, disclose in the report what service is being performed by what entity, *e.g.*, name of BOC/ILEC, or name of other non-section 272 affiliate.

   c.) For the period prior to March 30, 2004, disclose in the report whether or not any of these above described OI&M services were being performed by the section 272 affiliate on facilities either owned by Verizon BOC/ILECs or leased from a third party by Verizon BOC/ILECs. For each such service being performed by the section 272 affiliate, disclose in the report what service is being performed.

4. As of the end of the engagement period, inquire of management, identify, and document in the report which entity performs operating, installation, and maintenance functions over facilities either owned by each section 272 affiliate, or leased from a third party, by each section 272 affiliate.

   a.) Disclose in the report whether or not any of these OI&M services are being performed by the Verizon BOC/ILECs and/or other non-section 272 affiliate(s) on facilities either owned by each section 272 affiliate or leased from a third party by a section 272 affiliate. For each such OI&M service, disclose in the report what service is being performed by what entity, *e.g.*, name of BOC/ILEC, or name of other non-section 272 affiliate. Also disclose the date upon which each service was first provided.

   b.) Disclose in the report whether or not any of these OI&M services are being performed by any section 272 affiliate on facilities either owned by Verizon BOC/ILECs or leased from a third party by Verizon BOC/ILECs. For each such service being performed by a section 272 affiliate, disclose in the report what service is being performed by what entity, the name of the section 272 affiliate, and the date upon which the service was first provided.

5. Inquire of management to determine whether the Verizon BOC/ILECs perform any research and development (R&D) activities on behalf of the section 272 affiliates. If yes, obtain descriptions of R&D activities of the Verizon BOC/ILECs for the Audit Test Period and note any R&D related to the activities of each section 272 affiliate. For R&D related to the activities of each section 272 affiliate, inquire with Verizon BOC/ILEC personnel for more details, such as the extent of R&D provided, progress reports, cost, and whether the section 272 affiliate has been billed and has paid for this service and disclose in the report. For R&D services offered by any BOC/ILEC to any section 272 affiliate, inquire and disclose in the report as to whether R&D service is offered and/or has been performed by the BOC/ILECs when requested by unaffiliated entities.

6. Obtain as of the end of the Audit Test Period the balance sheet of each section 272 affiliate and a detailed listing of all fixed assets including capitalized software which agrees with the amount shown in the balance sheet. If the list does not agree, inquire and document why and disclose in the report by what amount the assets in the Balance Sheet are more than, or less than, as appropriate, the total amount of the assets on the detailed listing. Identify in the report the types of assets involved in these differences and provide explanations. Verify that the detailed listing includes a description and location of each item, date of purchase or acquisition, price paid and recorded, and from what BOC/ILEC or affiliate purchased or transferred (if purchased from a nonaffiliate, then indicate "Nonaffiliate"). Disclose in the report any item, including dollar amounts, where any of this information is missing. Inspect title and/or other documents, which reveal ownership, of a statistically valid sample of transmission and switching facilities, including capitalized software, and the land and buildings where those facilities are located, added since January 3, 2003. If any of these documents are not made available, disclose in the report. Look for and make a note of any facilities that are owned jointly with any Verizon BOC/ILEC and disclose in the report. The balance sheet information obtained in this procedure should also be used to perform Procedure 9 under Objectives V and VI.

<u>OBJECTIVE II</u>. Determine whether the separate affiliate required under section 272 of the Act has maintained books, records, and accounts in the manner prescribed by the Commission that are separate from the books, records, and accounts maintained by the Bell operating company.

<u>STANDARDS</u>

In CC Docket No. 96-150, Implementation of the Accounting Safeguards Under the Telecommunications Act of 1996, the FCC requires that each section 272 affiliate maintain books, records, and accounts, in accordance with generally accepted accounting principles (GAAP), and separate from those of the BOC. (See Report and Order, para. 170)

<u>PROCEDURES</u>

1. Obtain the general ledger (G/L) of each section 272 affiliate as of the end of the Audit Test Period and match the title on the G/L with the name of the affiliate on the certificate of incorporation to determine that a separate G/L is maintained. Look for special codes, if any, which may link this G/L to the G/L of any Verizon BOC/ILEC and provide documentation. State in the report whether or not a separate G/L is maintained, if not, explain why. Note: Linkage at corporate headquarters for consolidations is an accepted practice.

2. Obtain each section 272 affiliate's financial statements (i.e. Income Statement and Balance Sheet) as of the end of the Audit Test Period.

3. For each section 272 affiliate, obtain a list of lease agreements as of the end of the Audit Test Period. Identify leases for which the annual obligation listed in the lease agreement is $500,000 or more. Test both leases for which the section 272 affiliate is the lessor and leases for which the section 272 affiliate is the lessee. For a statistically valid sample of leases $500,000 or more, obtain a copy of the lease agreement, and make a note of the terms and conditions to determine whether these leases have been accounted for in accordance with GAAP. Determine whether client lease accounting policies are in accordance with GAAP. Disclose in the report any instance where these leases were not accounted for in accordance with GAAP.

<u>OBJECTIVE III</u>. Determine whether the separate affiliate required under section 272 of the Act has officers, directors, and employees that are separate from those of the Bell operating company.

<u>STANDARDS</u>

The FCC in CC Docket No. 96-149, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, interprets the above requirement further by stating the following:

- Separate officers, directors, and employees simply dictates that the same person may not simultaneously serve as an officer, director, or employee of both a BOC and its section 272 affiliate. (See First Report and Order, para. 178.)

<u>PROCEDURES</u>

1. Inquire, document and disclose in the report whether each section 272 affiliate and each Verizon BOC/ILEC maintain separate boards of directors, separate officers, and separate employees. For each Verizon BOC/ILEC and section 272 affiliate, obtain a list and formal confirmation from the Corporate Secretary's Office of the names of directors and officers of the Verizon BOC/ILEC and section 272 affiliate, including the dates of service for each Board member and officer for the engagement period. Compare the list of names of directors and officers of each Verizon BOC/ILEC with the list of names of directors and officers of each section 272 affiliate. For those names appearing on both lists, obtain explanations from management and request social security numbers and addresses to ensure that they are not the same individuals. Disclose in the report the number of directors and officers (who have the same social security number and address) who served simultaneously as a director and/or officer of any Verizon BOC/ILEC and any section 272 affiliate.

2. Obtain from their respective Human Resource Departments a list of names and social security numbers of all employees of each section 272 affiliate and each Verizon BOC/ILEC for the engagement period. Run a program which compares names and social security numbers of employees and document in the work papers the names appearing on both lists, respectively. For any employee appearing on both lists simultaneously, inquire and document why in the report.

<u>OBJECTIVE IV</u>. Determine that the separate affiliate required under section 272 of the Act has not obtained credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Bell operating company.

STANDARDS

The FCC in 47 C.F.R. part 53.203(d) indicates that a section 272 affiliate shall not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the BOC of which it is an affiliate.

The FCC also expands on this premise in CC Docket No. 96-149, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended. In this docket the Commission states that,

- A BOC cannot co-sign a contract or any other instrument with a section 272 affiliate that would allow each section 272 affiliate to obtain credit granting recourse to the BOC's assets. (See First Report and Order, para. 189)

- The BOC parent, or any other non-section 272 affiliate, cannot sign or co-sign a contract or any arrangement with a section 272 affiliate that would allow the creditor to have recourse to the BOC assets. (See First Report and Order, para. 189)

- A section 272 affiliate cannot enter any arrangement with any party that would permit the lender to have recourse to the BOC in the event of a default. (See First Report and Order, para. 189)

PROCEDURES

1. Document in the workpapers each section 272 affiliate's debt agreements/instruments and credit arrangements with lenders and major suppliers of goods and services. Look for guarantees of recourse to the Verizon BOC/ILECs' assets, either directly or indirectly through another affiliate, and document those instances and disclose in the report. Major suppliers are those having $500,000 or more in annual sales to the section 272 affiliate as stated in the agreement.

2. Using the lease agreements obtained in Objective II, Procedure 3, document any instances in which each section 272 affiliate's lease agreements (where the annual

obligation is $500,000 or more as stated in the agreement) have recourse to the assets of any Verizon BOC/ILEC, either directly or indirectly through another affiliate, and disclose in the report.

3. For all debt instruments, leases, and credit arrangements maintained by each section 272 affiliate in excess of $500,000 of annual obligations and for a sample of 10 debt instruments, leases and credit arrangements that are less than $500,000 in annual obligations (judgmental sample), obtain (positive) confirmations from loan institutions, major suppliers, and lessors to attest to the lack of recourse to any Verizon BOC/ILEC's assets. Disclose in the report any recourse noted.

Procedures for Accounting Requirements

<u>OBJECTIVE V</u>. Determine whether the separate affiliate required under section 272 of the Act has conducted all transactions with the Bell operating company on an arm's length basis with the *transactions reduced to writing* and available for public inspection.

<u>OBJECTIVE VI</u>. Determine whether or not the Bell operating company has accounted for all transactions with the separate affiliate in accordance with the accounting principles and rules approved by the Commission.

<u>STANDARDS</u>

The FCC in CC Docket No. 96-150, Implementation of the Accounting Safeguards Under the Telecommunications Act of 1996, interprets the above requirements further by stating:

- A section 272 affiliate shall conduct all transactions with the BOC of which it is an affiliate on an arm's length basis, pursuant to the accounting rules described in 47 C.F.R. part 32.27, Transactions with Affiliates, of the FCC Rules and Regulations, with any such transactions reduced to writing and available for public inspection. (See 47 C.F.R. part 53.203(e)). Part 32.27 requires the following:

  For transactions involving the sale or transfer of assets between the carrier and affiliates:

  a. assets sold or transferred between a carrier and its affiliate pursuant to a tariff, including a tariff filed with a state commission, shall be recorded in the appropriate revenue accounts at the tariff rate;

  b. nontariffed assets sold or transferred between a carrier and its affiliate that qualify for prevailing price valuation shall be recorded at prevailing price. In order to qualify for prevailing price valuation, sales of a particular asset to third parties must encompass greater than 25% of the total quantity of such product sold by an entity. Carriers shall apply this 25% threshold on an asset-by-asset basis rather than on a product line basis. See "Exceptions" below;

  c. all other assets sold by or transferred from a carrier to its affiliate, the asset shall be recorded at no less than the higher of fair market value or net book cost. See "Exceptions" below.

d. all other assets sold by or transferred to a carrier from its affiliate shall be recorded at no more than the lower of fair market value or net book cost. See "Exceptions" below.

Exceptions:
Floor. When assets are sold by or transferred from a carrier to an affiliate, the higher of fair market value and net book cost establishes a floor, below which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or greater than the floor, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, and is not otherwise anti-competitive.

Ceiling. When assets are purchased from or transferred from an affiliate to a carrier, the lower of fair market value and net book cost establishes a ceiling, above which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or less than the ceiling, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, and is not otherwise anti-competitive.

Threshold. Carriers are required to make a good faith determination of fair market value for an asset when the total aggregate annual value of the asset(s) reaches or exceeds $500,000, per affiliate. When a carrier reaches or exceeds the $500,000 threshold for a particular asset for the first time, the carrier must perform the market valuation and value the transaction on a going-forward basis in accordance with the affiliate transactions rules. When the total aggregate annual value of the asset(s) does not reach or exceeds $500,000, the asset(s) shall be recorded at net book cost.

For transactions involving the provision of services between the carrier and affiliates:

a. services provided between a carrier and its affiliate pursuant to a tariff, including a tariff filed with a state commission, shall be recorded in the appropriate revenue accounts at the tariffed rate;

b. nontariffed services provided between a carrier and its affiliate pursuant to publicly filed agreements submitted to a state commission pursuant to section 252(e) of the Communications Act of 1934 or statements of generally available terms pursuant to section 252(f) shall be recorded using the charges appearing in such publicly-filed agreements or statements;

c. nontariffed services provided between a carrier and its affiliate that qualify for prevailing price valuation shall be recorded at the prevailing price. In order to qualify for prevailing price valuation, sales of a particular service to third parties must encompass greater than 25% of the total quantity of such service sold by an entity. Carriers shall apply this 25% threshold on a service-by-service basis rather than on a service line basis. See "Exceptions" below;

d. all other services sold by or transferred to a carrier from its affiliate, shall be recorded at no more than the lower of fair market value and fully distributed cost. See "Exceptions" below;

e. all other services sold by or transferred from a carrier to its affiliate shall be recorded at no less than the higher of fair market value and fully distributed cost. See "Exceptions" below.

Exceptions:
Floor. When services are sold by or transferred from a carrier to an affiliate, the higher of fair market value and fully distributed cost establishes a floor, below which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or greater than the floor, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, and is not otherwise anti-competitive.

Ceiling. When services are purchased from or transferred from an affiliate to a carrier, the lower of fair market value and fully distributed cost establishes a ceiling, above which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or less than the ceiling, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, and is not otherwise anti-competitive.

Threshold. Carriers are required to make a good faith determination of fair market value for a service when the total aggregate annual value of that service reaches or exceeds $500,000, per affiliate. When a carrier reaches or exceeds the $500,000 threshold for a particular service for the first time, the carrier must perform the market valuation and value the transaction on a going-forward basis in accordance with the affiliate transactions rules. When the total aggregate annual value of the service does not reach or exceeds $500,000, the service shall be recorded at fully distributed cost.

- Fully distributed cost is determined by following the standards contained in 47 C.F.R. part 64.901, Allocation of Costs, of the FCC Rules and Regulations. These rules emphasize direct assignment and cost causation. First, costs are to be directly assigned either to regulated or nonregulated activities to the maximum extent possible. Then, costs which cannot be directly assigned are to be grouped into homogeneous cost pools and allocated in accordance with direct or indirect measures of cost causation. Residual costs which cannot be apportioned on any cost-causative basis will be apportioned using the general allocator. The general allocator is the ratio of all expenses directly assigned or attributed to nonregulated activities, to the total of all (regulated and nonregulated) directly assigned or attributed expenses.

- A BOC and a section 272 affiliate may provide in-house services to one another, except for the provision of operating, installation, or maintenance services prior to March 30, 2004. These in-house services, however, must be provided on an arm's length basis, and must be in writing. (See CC Docket No. 96-149, First Report and Order, para 180; see also WC Docket No. 03-228, Report and Order, para. 8, 12, 16, 24, 31)

- Provision of exchange and exchange access services and unbundled network elements constitute transactions requiring disclosure (See CC Docket No. 96-150, Report and Order, para. 124). These transactions include the provision of transmission and switching facilities by the BOC and its affiliate to one another. (See CC Docket No. 96-149, First Report and Order, para. 193)

- The separate affiliate must provide a detailed written description of the asset or service transferred and the terms and conditions of the transaction on the internet within ten days of the transaction through the company's home page. (Note: a transaction is deemed to have occurred once the BOC and its affiliate have agreed upon the terms and conditions of the transaction, not when the service is actually performed or the asset actually sold (See CC Docket No. 96-150, Report and Order, para. 124).) The description of the asset or service and the terms and conditions of the transaction should be sufficiently detailed to allow evaluation of compliance with accounting rules. This information must also be made available for public inspection at the principal place of business of the BOC. The information made available at the principal place of business of the BOC must include a certification statement identical to the certification statement currently required to be included with all Automated Reporting and Management Information System ("ARMIS") reports. Such certification statement declares that an officer of the BOC has examined the submission and that to the best of the officer's knowledge all statements of fact contained in the submission are true and the submission is an accurate statement of the affairs of the BOC for the relevant period. (See CC Docket No. 96-150, Report and Order, para. 122)

- Section 272(b)(3) does not preclude an affiliate of the BOC, such as a service affiliate, or the parent company of both the BOC and its section 272 affiliate from performing functions for both the BOC and its section 272 affiliate. The affiliate transaction rules apply to transactions between the BOC and a nonregulated affiliate of the BOC, such as a service affiliate, and to transactions between the

BOC and its parent company. Under the principle of "chain transactions," the affiliate transactions rules also apply to any transactions between the section 272 affiliate and a nonregulated affiliate of the BOC, such as a service affiliate, that ultimately result in an asset or service being provided to the BOC. (See CC Docket No. 96-150, Report and Order, para. 183)

- In the case of transactions for assets and services subject to section 272, a BOC may record such transactions at prevailing price regardless of whether the 25% threshold has been satisfied. (See CC Docket No. 96-150, Report and Order, para. 137; CC Docket No. 00-199, Report and Order, Appendix F, Part 32.27)

- Nondiscrimination requirements extend to any good, service, facility, or information that a BOC provides to its section 272 affiliate(s) with the exception of joint marketing, which is covered in section 272(g) of the Act. Unaffiliated entities must have equal opportunity to acquire any such good, service, facility, or information. In particular, if a BOC were to decide to transfer ownership of a unique facility, such as its Official Services network, to a section 272 affiliate, it must ensure that the section 272 affiliate and unaffiliated entities have an equal opportunity to obtain ownership of this facility. (See CC Docket No 96-149, First Report and Order, para. 218)

- Interstate rate base, revenue requirements, and price cap indices of the BOC must be reduced by the costs related to any regulated facilities transferred to each section 272 affiliate. (See CC Docket No. 96-150, Report and Order, para. 265; see also C.F.R. 61.45(d)(1)(v))

PROCEDURES

1. Document in the working papers the procedures used by the Verizon BOCs & ILECs to identify, track, respond, and take corrective action to competitors' complaints with respect to alleged violations of the section 272 requirements. Obtain from the Verizon BOC/ILECs a list of all FCC formal complaints, as defined in 47 CFR 1.720; FCC informal complaints, as defined in 47 CFR 1.716 and any written complaints made to a state regulatory commission from competitors involving alleged noncompliance with section 272 for the provision or procurement of goods, services, facilities, and information, or in the establishment of standards which were filed during the engagement period. This list should also include outstanding complaints from the prior engagement period, which had not been resolved during that period. The list should group the complaints in the following categories:

    - allegations of cross-subsidies (for Objectives V and VI);

- allegations of discriminatory provision or procurement of goods, services, facilities, customer network services information (excludes customer proprietary network information (CPNI)), or the establishment of standards (for Objective VII);

- allegations of discriminatory processing of orders for, and provisioning of, exchange access and exchange services and unbundled network elements, and discriminatory resolution of network problems (for Objective VIII);

- allegations of discriminatory availability of exchange access facilities (for Objective IX);

- allegations of discriminatory availability of interLATA facilities or services not at the same rates and not on the same terms and conditions as the interLATA affiliate (for Objective XI).

For each group of complaints, determine by inquiry and documentation how many of these complaints were under investigation, how many complaints had been resolved and in what time frame they had been resolved, if feasible, and disclose in the report. For those complaints that had been resolved, document and disclose in the report how those allegations were concluded and, if the complaint was upheld, inquire and document and disclose in the report what steps the company has taken to prevent those practices from recurring. For all complaints that were filed in the previous engagement period, but were still open as of January 3, 2003, determine by inquiry and review of documentation how many of these complaints were under investigation as of the end of the current engagement period, how many complaints have been resolved as of the end of the current engagement period (and in what time frame they had been resolved), and disclose results in the audit report. For those complaints that have been resolved, document and disclose in the report how those allegations were concluded, and if the complaint was upheld inquire and document and disclose in the report what steps the company has taken to prevent those practices from recurring.

Note: Although applicable to complaints pertaining to Objective V/VI, VII, VIII, IX and XI, this procedure appears only once and will be performed only once for Objectives V/VI, VII, VIII, IX and XI. Reporting of the results of this procedure in the final report should be found here under Objective V/VI, Procedure 1, and should include the results for each respective objective.

2. Obtain, from each Verizon BOC/ILEC and each section 272 affiliate, written procedures for transactions with affiliates. Compare these procedures with the FCC rules and regulations indicated as "standards" above. Note and describe any differences and disclose in the report.

3. Inquire and describe how each Verizon BOC/ILEC and each section 272 affiliate disseminate the FCC rules and regulations and raise awareness among employees for compliance with the affiliate transactions rules. For this purpose, describe in the report type and frequency of training, if any, literature distributed, company's policy, and document the nature of the supervision received by employees responsible for affiliate transactions. Interview employees responsible for the development and recording of affiliate transactions costs in the books of record of the carrier to determine awareness of these rules. Disclose in the report whether these employees demonstrated knowledge of these rules.

4. a. Obtain a listing of all written agreements for services and for interLATA and exchange access facilities between each Verizon BOC/ILEC and each section 272 affiliate which were in effect during the Audit Test Period. Note which agreements are still in effect. For those agreements no longer in effect, indicate the termination date; identify agreements terminated prematurely and document why and disclose in the report. Inquire and document and disclose in the report the provisioning of any service without a written agreement during the engagement period.

   b. Obtain a listing of all written agreements, amendments and addenda that became effective during the Audit Test Period. For a statistically valid sample of such agreements, amendments and addenda, obtain (include in the practitioner work papers) copies of written agreements, amendments and addenda.

5. Using the sample of the agreements, amendments and addenda obtained in Procedure 4b, view each company's web site on the internet and compare the prices and terms and conditions of services and assets shown on this site to the agreements provided in Procedure 4b above. Disclose in the report any instance where an agreement contains an item(s) that does not agree with the corresponding item on the internet, as determined in Attachment 1. Taking those instance(s) where an agreement contains an item(s) that does not agree with the corresponding item on the internet, develop and disclose in the report the error rate as a percentage. This error rate will be developed utilizing Attachment 1 (Columns D and E) and summarized using Attachment 2 (Columns B and C) as provided in this agreed-upon procedures engagement. Using the same sample as above, obtain a list of the principal places of business (BOC headquarters) where these agreements are made available for public inspection. Using a judgmental sample of locations agreed to by the Joint Oversight Team, by physical inspection, determine whether the same information is made available for public inspection at the principal place of business (BOC headquarters) of the Verizon BOC/ILEC. Disclose in the report the total number of sampled agreements where an item in the sampled agreement does not agree with the corresponding item in the agreement at the public inspection site. Describe any differences and inquire why such differences exist and disclose in the report. If the company makes any claim of confidentiality for nondisclosure, obtain details. It should be noted that these transactions should be posted for public inspection within ten days of

their occurrence. Document in the working papers the dates when the sample agreements were signed and/or the services were first rendered (whichever took place first) and the dates of posting on the internet. Inquire and note in the report late postings and reasons when posting took place after ten days of signing of agreement or provision of service (whichever took place first). Document in the working papers the procedures the company has in place for posting these transactions on a timely basis. The information provided on the internet should be in sufficient detail to allow evaluation for compliance with accounting rules (see Docket No. 96-150, Report and Order, para. 122). Such disclosures should include a description of the rates, terms, and conditions of all transactions, as well as the frequency of recurring transactions and the approximate date of completed transactions. For asset transfers, the disclosure should include the appropriate quantity and, if relevant, the quality of the transferred assets. For affiliate transactions involving services priced at fully distributed costs or estimated fair market value, the disclosure should include the number and type of personnel assigned to the project and the level of expertise of such personnel (including the associated rate per service unit (e.g. contacts, hours, days, etc)). Service transactions should also disclose any special equipment used to provide the service, and the length of time required to complete the transaction. Additionally, the disclosure should state whether the hourly rate is a fully-loaded rate, and whether or not that rate includes the cost of materials and all direct and indirect miscellaneous and overhead costs, for goods and services provided at FDC. If the information disclosed on the internet is not sufficiently detailed as described in Attachment 1 (Columns G and H), disclose in the report those particular item(s). Taking those instances where the internet did not contain sufficient details, develop and disclose in the report the error rate as a percentage. This error rate will be developed utilizing Attachment 1 (Columns G and H) and summarized in Attachment 2 (Columns D and E) as provided in this agreed-upon procedures engagement. (See CC Docket No. 98-121, In the Matter of Application of BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana; *Memorandum Opinion and Order*; Released October 13, 1998, para. 337.) Obtain copies of these public postings and include in the working papers.

6. Obtain a listing and amounts of all nontariffed services rendered by month by Verizon BOC/ILECs to each section 272 affiliate during the Audit Test Period. Determine which of these services are made available to the section 272 affiliate and not made available to third parties, and which services are made available to both the section 272 affiliate and to third parties.

   a. From the services not made available to third parties, select a statistically valid sample. For each transaction in the sample, determine compliance with part 32.27 of the Commission's rules by comparing unit charges to Fully Distributed Cost (FDC), or Fair Market Value (FMV) as appropriate; also check for any "chain" transactions. For new transactions after September 27, 2004, where the total aggregate annual value of a service provided by a Verizon BOC/ILEC to a section 272 affiliate that is not required by section 272 to be made available to third parties reaches the $500,000 threshold contained in part 32.27, obtain a comparison of fair market value to fully distributed costs. If Verizon should contend that an estimate of fair market value can not be established by Verizon and/or an independent third party for any services, such as certain component parts of joint marketing that are offered by the Verizon BOCs to their section 272 affiliates but that are not offered to third parties, obtain from Verizon the reasons and provide documentation of the results of Verizon's and the independent third party's analyses and retain in the workpapers. When differences exist between the amount recorded in Verizon BOC/ILEC financial records, and the amount to be charged in accordance with the affiliate transaction rules, note in the report the number of instances and related amounts, and, after inquiry, document in the report the reasons for these occurrences. Disclose in the report any differences between the amount the section 272 affiliate has recorded for these services in its books of account and the amount the section 272 affiliate has paid for the same services to the Verizon BOC/ILEC.

b. From the services made available to both the section 272 affiliates and to third parties, select a statistically valid sample and for each transaction compare the amounts recorded for the sampled services in the books of the Verizon BOC/ILEC with the amounts recorded for the sampled services in the books of the section 272 affiliate, and with the amounts the section 272 affiliate has paid to the Verizon BOC/ILEC for the sampled services. When differences exist, note in the report the number of instances and related amounts, and, after inquiry, document in the report the reasons for these occurrences. Disclose in the report any difference between the amount recorded in the books of the Verizon BOC/ILEC and the amount the section 272 affiliate has paid to the Verizon BOC/ILEC for the same services. Determine if the transaction was billed to the section 272 affiliate at rates in an interconnection agreement under section 252(e), at the rates in a statement of generally available terms under section 252(f), or at prevailing price, as provided in part 32.27 (c) and (d) of the Commission's rules. Disclose in the report the number of instances and the amounts by which each item is less than or more than the amount required by the rules, and, after inquiry, the reasons for these occurrences.

7. Using the listing obtained in Procedure 6 of services rendered by month by Verizon BOC/ILECs to each section 272 affiliate during the Audit Test Period, determine if any of the services rendered include operations, maintenance, or installation (OI&M) functions.

a. Disclose in the report whether the Verizon BOC/ILECs are rendering any OI&M services to each section 272 affiliate, and the date any such provision of service started. Disclose in the report whether any such OI&M services are or are not made available to third parties.

b. If the Verizon BOC/ILECs render OI&M services to any section 272 affiliate, determine the following and disclose in the report:

- date affiliate agreement was effective (date signed);
- date affiliate agreement was posted to the internet;
- date each Verizon BOC/ILEC filed its Cost Allocation Manual (CAM) amendments with the FCC, and the effective date of those CAM amendments.

8. Obtain a listing and amounts of all services rendered by month to the Verizon BOC/ILECs by each section 272 affiliate during the Audit Test Period. Using a statistically valid sample, compare unit charges to tariff rates, PMP, FDC, or FMV, as appropriate, to determine whether these services were recorded in the books of the Verizon BOC/ILEC in accordance with the affiliate transactions rules. Also check for the existence and proper recording of any "chain" transactions. When differences exist, note in the report the number of instances and the amount by which each item is greater than or less than the amount required by the rules. Inquire and make a note of reasons for these occurrences in the report. Disclose in the report the differences between the amount the Verizon BOC/ILEC has recorded for the services in its books of account and the amount the Verizon BOC/ILEC has paid for the same services to the section 272 affiliate.

9. Using the balance sheet and detailed listing information obtained in Procedure 6 under Objective I, for items added since January 3, 2003, perform the following steps:

a. For those items purchased or transferred from any Verizon BOC/ILEC, obtain net book cost and fair market value. Inquire and document in the report how the fair market value was determined. Inspect these transactions to determine whether they were recorded in the books of the Verizon BOC/ILEC at the higher of FMV or net book cost, as required by the Commission's rules in part 32.27 and disclose in the report.

b. For those items purchased or transferred from another affiliate, identify and document in the report whether they were originally transferred from any Verizon BOC/ILEC to other affiliates.

c. For those items purchased or transferred from any Verizon BOC/ILEC, either directly or through another affiliate, since January 3, 2003, also inquire and obtain details as to how the Verizon BOC/ILEC made an equal opportunity available to unaffiliated entities to obtain ownership of the facilities and disclose in the report. Describe and disclose in the report how and upon what basis the Verizon BOC/ILEC decided to transfer/sell the facilities to a section 272 affiliate instead of an unaffiliated entity.

10. Obtain as of the end of the Audit Test Period a detailed listing of all fixed assets which were purchased or transferred from each section 272 affiliate to any Verizon BOC/ILEC

since January 3, 2003. This detailed listing should include a full description of each item, location, date of purchase, price paid and recorded, and from whom purchased or transferred. For those items purchased or transferred from a section 272 affiliate, obtain net book cost and fair market value. Also determine if these items were originally transferred to the section 272 affiliate from some other affiliate (BOC or other), or purchased originally by the section 272 affiliate. Inspect these transactions to determine whether they were recorded in the books of the Verizon BOC/ILEC at the lower of FMV or net book cost, as required by the Commission's rules in part 32.27. Disclose results of this inspection in the audit report.

11. Where assets and/or services are priced pursuant to section 252(e) (i.e., as approved by the regulatory commissions) or statements of generally available terms pursuant to section 252(f), for a statistically valid sample of assets and/or services, compare the price each Verizon BOC/ILEC charges each section 272 affiliate to the stated price in the publicly-filed agreements or statements and document any differences in the report.

12. Inquire and obtain details as to whether any part of any Verizon BOC/ILEC's Official Services network was transferred or sold to a section 272 affiliate since January 3, 2003. In addition to the requirements for Procedure 9, for any transfer or sale of Official Services network assets on or after January 3, 2003, inquire and obtain details as to how the Verizon BOC/ILEC made an equal opportunity available to unaffiliated entities to obtain ownership of the facilities. Describe how and upon what basis the Verizon BOC/ILEC decided to transfer/sell the facilities to a section 272 affiliate instead of an unaffiliated entity. Disclose all of the above facts in the report.

Procedures for Nondiscrimination Requirements

OBJECTIVE VII. Determine whether or not the Bell operating company has discriminated between the separate affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or the establishment of standards.

STANDARDS

The FCC in CC Docket No. 96-149, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, establishes some non-discriminatory rules and regulations. These rules and regulations do not permit a Bell operating company (BOC) to discriminate in the following manner:

- by giving preference to a section 272 affiliate's equipment in the procurement process. (See First Report and Order, para. 16)
- in awarding contracts for telecommunications equipment directly to their affiliate in a manner that violates section 273(e)(1) or 273(e)(2). (See First Report and Order, para. 234)
- by failing to provide advance information about network changes to its competitors. (See First Report and Order, para. 16)
- by not offering third parties the same goods, services, facilities and information (excludes customer proprietary network information (CPNI) and joint marketing) that it provides to its section 272 affiliate at the same rates, terms, and conditions. (See First Report and Order, para. 202 and 218)

NOTES:

(i) BOCs are not required under the nondiscrimination rules and regulations to provide to third parties Customer Proprietary Network Information (CPNI) that is shared with affiliates (see *Second Report and Order*, CC Docket No. 96-115, Released February 26, 1998, para. 169). The provision of "information" referenced in the nondiscriminatory rules and regulations excludes CPNI. CPNI is defined in section 222(f)(1) of the Act and includes information that is personal to customers as well as commercially valuable to carriers, such as to whom, where and when a customer places a call, as well as the types of service offerings to which the customer subscribes and the extent the service is used.

(ii) BOCs are allowed to jointly market and sell affiliate-provided interLATA services without offering comparable joint marketing opportunities to other providers of interLATA services (see section 272(g)(2) of the Act, and CC Docket No. 96-149, First Report and Order, Paragraphs 291-292). However, if BOCs market or sell their telephone exchange services through joint marketing conducted by the section 272 affiliate, then the BOCs must also permit third parties to market and sell its telephone exchange services (see section 272(g)(1) of the Act).

- in establishing or adopting any standards that favor its section 272 affiliate(s) over third parties. (See First Report and Order, para. 208 and 229)

- in developing new services solely for its section 272 affiliate(s). (See First Report and Order, para. 210)

- in purposely delaying the implementation of an innovative new service by denying a competitor's reasonable request for interstate exchange access until its section 272 affiliate was ready to provide competing service. (See First Report and Order, para. 211)

- in marketing its affiliate's interLATA services to inbound callers without informing them of their right to select the interLATA carrier of their choice. (See First Report and Order, para. 292)

NOTE:

A BOC's obligation to inform callers of their long distance choices is limited to customers who order *new* local exchange *service*. A caller orders "new service" when the customer either receives service from the BOC for the first time, or moves to another location within the BOC's in-region territory. (*See In the Matter of AT&T Corp., Complainant, v. New York Telephone Company, d/b/a Bell Atlantic – New York, Defendant*, Memorandum Opinion and Order, File No. EB-00-MD-011; FCC 00-362; at ¶¶ 13-15.)

In addition, a section 272 affiliate may not market or sell information services and BOC telephone exchange services together, unless the BOC permits other information service providers to market and sell telephone exchange services. (See First Report and Order, para. 287)

PROCEDURES

1. Obtain the Verizon BOC/ILECs' written procurement procedures, practices, and policies. Review these policies for any stated purchasing preferences, and disclose in the report.

Also disclose in the report the bidding and selection processes of the Verizon BOC/ILECs, and how the Verizon BOC/ILECs disseminate requests for proposals (RFPs) to affiliates and third parties.

2. Obtain and inspect the Verizon BOCs' procurement awards to each section 272 affiliate during the Audit Test Period and inspect bids submitted by each section 272 affiliate and third party, note terms, and discuss with Verizon BOC representatives how the selection was made and disclose in the report. Compare this practice with the Verizon BOC/ILEC written procurement procedures and note any differences. Disclose in the report all instances of procurement awards given to the section 272 affiliates. For these awards, disclose in the report the general differences between the terms submitted by the section 272 affiliates and other bidders.

3. Obtain a list of all goods (including software), services, facilities, and customer network services information, excluding CPNI as defined in section 222(f)(1) of the Act, and exchange access services and facilities inspected in Objective IX, made available to each section 272 affiliate by the Verizon BOC/ILECs. For a statistically valid sample of items from this list, inquire and obtain copies of the media used by the Verizon BOC/ILECs to inform unaffiliated entities of the availability of the same goods, services, facilities, and information at the same price, and on the same terms and conditions. Disclose in the report the results of this procedure.

4. Obtain a list from the Verizon BOCs of all unaffiliated entities who have purchased the same goods, as the section 272 affiliates, (including software), services, facilities, and customer network services information (excludes CPNI) from the Verizon BOCs (except for exchange access services, and interLATA services that are the subject of other procedures), during the Audit Test Period. If any, describe what goods, services, facilities, and customer network services information were purchased and the extent of purchases made.

   a. For the list of unaffiliated entities obtained above, obtain a list of billed items by entity. Select a statistically valid sample of billed items for the same goods (including software), services, facilities, and customer network services information (excludes CPNI), and excluding local exchange services, that were purchased by the section 272 affiliates. For the sample, compare the rates, terms, and conditions of the sampled items to the rates, terms, and conditions of the items purchased by each section 272 affiliate. Note any differences and disclose in the report. For the sampled items, document the amount each section 272 affiliate was billed by the BOC, the amount the BOC recorded in its books, and the amount each section 272 affiliate paid for the same items purchased from the Verizon BOC, and disclose any differences in the report.

   b. For local exchange services, compile a list of services billed to the section 272 affiliates by USOC (Universal Service Order Code) in one month, randomly selected, including the rates billed by USOC, by state. Select a statistical sample of USOCs billed and compare the rates charged per USOC selected to the applicable tariff rate. Note any differences and disclose in the report. From the sample items, compile a list of invoices on which the sampled items appeared. From the list of invoices, randomly select 25 invoices and document the amount each section 272 affiliate was billed by the BOC, the amount the BOC recorded in its books, and the amount the section 272 affiliate paid, and disclose differences in the report.

5. Document and disclose in the report how the Verizon BOCs disseminate information about network changes, the establishment or adoption of new network standards, and the availability of new network services to each section 272 affiliate and to unaffiliated entities. Note any differences in the report.

6. At the service call centers observed in Procedure 7 below, obtain and inspect scripts that the Verizon BOCs' customer service representatives recite to new customers calling, or visiting customer service centers, to establish new local telephone service or to move an existing local telephone service to another location within the BOC in-region territory. In addition, obtain the script that is used in Verizon's Consumer Call Centers' Voice Response Unit (VRU). If these scripts contain language to attempt to sell interLATA services, note and disclose in the report whether these scripts inform the consumers that there are other providers of interLATA services and that these providers, along with the interLATA service affiliates, are identified to the consumers. In addition, obtain and inspect the written content of the Verizon BOC website for on-line ordering of new service or to move an existing local telephone service; note and disclose in the report whether the consumers are informed that there are other providers of interLATA services and that these providers, along with the interLATA service affiliate, are identified to the consumers.

7. Obtain a complete listing, as of the end of the Audit Test Period, of all Verizon BOC sales and support customer service call centers.

   a. From the listing, compile a list of Verizon BOC call centers responding to inbound callers requesting to establish new local telephone service or to move an existing local telephone service to another location within the BOC in-region territory. From this listing, identify and group each call center by type of customers, viz., "Consumer" or "Business." Using a random number generator, select six Consumer call centers and four Business call centers. Listen in to a statistically valid number of calls (100 in total, or 10 per call center) in which the customer service representatives attempt to market the section 272 affiliate's interLATA service to callers requesting to establish new local telephone service or to move an existing local telephone service. Labor union concurrence may be needed for this procedure. Note the equal access messages conveyed while listening in, including clarity of the equal access message delivered. Note and disclose in the report any instances where the customer service representative attempted to influence the caller to obtain the interLATA services of the section 272 affiliate prior to providing the equal access message, did not inform the caller of other providers of interLATA services, or did not inform the caller of his right to select the interLATA services provider.

b. From the listing, compile a list of call centers that might incidentally respond to inbound callers requesting to establish new local telephone service or to move an existing local telephone service to another location within the BOC in-region territory (such as sales and service centers that usually receive customer inquiries from existing customers). Using a random number generator, select three such Consumer call centers and two Business call centers, and listen in to 20 calls per center. Labor union concurrence may be needed for this procedure. If any customer requests to establish new local telephone service or to move an existing local telephone service, the practitioner should report the results of the 100 total calls to the Oversight Team for further instructions. The Oversight Team will inform Verizon of the instructions provided to the practitioner.

c. Make a statistically valid number of test calls into Verizon's Consumer Call Centers' Voice Response Unit to listen for the equal access scripting message that is heard by customers prior to reaching a Consumer service representative. Note and disclose in the report any instances where the equal access scripting message was not heard.

8. Obtain a listing of all call centers managed by third parties in which representatives of third-party contractors of the Verizon BOC respond or might incidentally respond to customers requesting to establish new local telephone service or to move existing local telephone service to another location within the BOC in-region territory. Using a random number generator, select three Consumer call centers and the one Business call center. Listen in to 25 calls per call center. If any customer requests to establish new local telephone service or to move an existing local telephone service, the practitioner should report the results of the 100 total calls to the Oversight Team for further instructions. The Oversight Team will inform Verizon of the instructions provided to the practitioner.

9. Identify the controls utilized by Verizon BOCs and the third party contractors hired for inbound telemarketing to assure compliance by Verizon BOCs with section 272. Compare Verizon BOC controls with third party contractor controls and document differences in the audit report. Describe all controls in the report.

10. Obtain and review each of the contracts between Verizon BOCs and third party contractors that provide telemarketing of the section 272 affiliate's interLATA services. Document in the audit report all controls contained in the contracts relating to section 272.

<u>OBJECTIVE VIII</u>. Determine whether or not the Bell operating company and an affiliate subject to section 251(c) of the Act have fulfilled requests from unaffiliated entities for telephone exchange service and exchange access within a period no longer than the period in which it provides such telephone exchange service and exchange access to itself or its affiliates.

STANDARDS

Although the FCC in CC Docket No. 96-149, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, reached various conclusions, further proceedings regarding performance measurements (currently underway) will provide the implementing rules and regulations. We will revise these procedures to conform to the new rules and regulations when adopted by the FCC and to the extent in effect during the engagement period. The conclusions reached by the Commission provide that,

- for equivalent requests the response time a BOC provides to unaffiliated entities should be no greater than the response time it provides to itself or its affiliate. (See First Report and Order, para 240)
- a BOC must make available to unaffiliated entities information regarding the service intervals in which the BOC provides service to itself or its affiliates. (See First Report and Order, para. 242)
- a BOC must not provide a lower quality service to competing interLATA service providers than the service it provides to its section 272 affiliate at a given price. (See First Report and Order, para. 16)

In its section 271 applications, Verizon made commitments regarding compliance with section 272(e)(1) of the Act. This included the commitment to provide the performance monitoring that will assist in confirmation of nondiscriminatory performance in Verizon's dealings with its section 272 affiliates. If the Commission adopts reporting requirements, Verizon BOC/ILEC will fully comply.

PROCEDURES

1. Document in the working papers the practices and processes each Verizon BOC/ILEC has in place to fulfill requests for telephone exchange service and exchange access service for the section 272 affiliates, BOC and other BOC affiliates, and nonaffiliates in each state where Verizon has been authorized to provide in-region interLATA services. If the section 272 affiliates, or BOC and other BOC affiliates, are treated differently than nonaffiliates, note and describe all differences in the report. Describe in the report the BOC's internal controls and procedures designed to implement its duty to provide

nondiscriminatory service.

2. For each state where Verizon has been authorized to provide in-region interLATA services, document in the working papers the processes and procedures followed by the Verizon BOC/ILEC to provide information regarding the availability of facilities used in the provision of special access service to its section 272 affiliates, BOC and other BOC affiliates, and nonaffiliates. Note any differences. Inquire of management whether any employees of the section 272 affiliates or other affiliates have access to, or have obtained, information regarding special access facilities availability in a manner different from the manner made available to nonaffiliates (e.g., direct calls, placed prior to ordering, from the section 272 affiliates or BOC account managers to employees who may have facilities availability information). Disclose in the report any such instances.

3. For each state where Verizon has been authorized to provide in-region interLATA services, obtain written methodology that the Verizon BOC/ILEC follows to document time intervals for processing orders (for initial installation requests, subsequent requests for improvement, upgrades or modifications of service, or repair and maintenance), provisioning of service, and performing repair and maintenance services for the section 272 affiliates, BOC and other BOC affiliates, and nonaffiliates for the services described in Procedure 4, below. Briefly describe this methodology in the report. If the company does not have any written procedures inquire and document why in the report.

4. For each state where Verizon has been authorized to provide in-region interLATA services, obtain and include as an attachment to the report, performance data maintained by each Verizon BOC/ILEC during the engagement period, by month. Indicate time intervals for processing orders (on initial installation requests, subsequent requests for improvement, upgrades or modifications of service, and repair and maintenance), for provisioning of service, and for performing repair and maintenance services for the section 272 affiliates, the BOC and other BOC affiliates, and nonaffiliates, as separate groups. Provide performance data for the following services:

   - Telephone exchange service, if any of the separate groups resells local service or intraLATA toll service. This does not include the selling of BOC local service or intraLATA toll service to retail customers.

   - Exchange access services as submitted through an ASR for DSO, DS1, DS3, feature group D, and OCn, as individual groups. For the BOC and other BOC affiliate group, exchange access measurements should cover services provided to end users on a retail basis and services provided to affiliates on a wholesale basis.

   - Unbundled network elements if any section 272 affiliate purchases unbundled network elements.

- Presubscribed Interexchange Carrier (PIC) change orders for intraLATA toll services and interLATA services.

The table below should be used as guidance for the information to be included in the metrics.

If performance measures are applicable for either the "section 272 affiliates" or the "BOC and other BOC affiliates" groups, performance metrics for nonaffiliates are required. If performance measures are not applicable for the "nonaffiliated" group, performance metrics are not required to be reported for either the "section 272 affiliates" or the "BOC and other BOC affiliates" groups. When reporting performance measures for the "nonaffiliates" group, only performance measures for the services purchased by the "section 272 affiliates" and/or the "BOC and other BOC affiliates" need be reported.

For each group (section 272 affiliates, the BOC and other BOC affiliates, and nonaffiliates) and each service category (telephone exchange service, exchange access service, UNEs, and PIC change orders) combination in the table below for which Verizon makes a claim of "not applicable", the practitioner must confirm independently that there are no such measurements to be reported, or get a representation letter from management as to why such measurements do not need to be reported in this engagement.

SUMMARY OF COMPANY TYPE AND SERVICE TYPES FOR PERFORMANCE MEASUREMENT REPORTING

Company Type	Telephone Exchange Service	Exchange Access Service (ASRs Only)	UNEs	PIC Change Orders (both interLATA ar intraLATA PIC changes)
Section 272 Affiliate	Included - if the section 272 affiliate resells local service or intraLATA toll service	Included	Included if applicable	Included
Other Affiliates, Including the BOC(s)	Included - to measure services provided on a **Resale** basis	Included - to measure services provided to end users on a **Retail** basis, and **Wholesale** services provided to affiliates	Included only if any 272 affiliate leases any UNEs from the BOC - if applicable	Included if applicabl
Non-Affiliates (includes all entities purchasing services for resale or on a wholesale basis)	Included - to measure services provided on a **Resale** basis	Included	Included only if any 272 affiliate leases any UNEs from the BOC - if applicable	Included

The performance measures should include the requested performance data by month, including related parity scores, for each state beginning with the first whole month of data following January 3, 2003, or section 271 approval if later, for that state and ending on December 31, 2004. Where appropriate, the performance measures data shall reflect the standard deviation, as well as mean. For purposes of inclusion in the audit report, the practitioner should obtain all restatements of any performance data, and include in the report the latest restatement. For any months, states, or parity scores for which Verizon makes a claim of "not applicable" or "not available," the practitioner must confirm independently that there are no such measurements to be reported, or get a representation letter from management as to why such measurements do not need to be reported in this engagement.